

Quarterly Commentary: Impact Quantitative Portfolios (QPs) Large Cap Core ESG

Second Quarter (Q2) 2020

Market Environment

The US economy remained mired in an economic maelstrom resulting from the lockdowns brought on by the COVID-19 virus. The phased reopening that states have begun to implement has provided a boost to economic activity, but there are still many segments of the economy that will take time to recover. The Bureau of Economic Analysis reported its third estimate of first-quarter 2020 gross domestic product (GDP) of -5.0%, in line with the prior estimate, but, of course, far below the fourth-quarter 2019 reading. The negative impact of COVID-19 on the employment situation was significant in March and April, with employers shedding 1.4 million and 20.7 million jobs, respectively. However, the May employment report showed an astonishing increase in the number of jobs, as 2.5 million were added to payrolls when analysts had expected additional losses of 7.5 million. The unemployment rate climbed to 13.3%. The Federal Open Market Committee (FOMC) maintained the aggressive monetary policy response to the crisis, leaving the federal funds rate target range of 0% to 0.25% unchanged.

Portfolio Commentary

The Quantitative Portfolio: Impact Large Core—ESG strategy generated a gross return of 21.91% compared with 21.41% for the CRSP US Large Cap Index. On a year-to-date basis, the portfolio has returned -1.88% relative to -2.16% for the benchmark.

US large cap equities bounced back sharply, posting a double-digit increase in the second quarter. The strategy, which seeks to provide passive-like returns, tracked the broad-based large cap index with a gain of 12.46% in April, 5.43% in May, and 2.82% in June.

As the portfolio construction process maintains sector weights in line with those of the benchmark, the sector-weighting differences minimally detracted from the portfolio's performance. Stock selection often plays a larger role in relative performance, due to the idiosyncratic risk associated with holding a subset of the index. Stock selection for the quarter contributed 55 basis points overall. The sectors that experienced positive stock selection included Information Technology and Industrials, whereas the sectors with negative selection were Communication Services and Consumer Discretionary.

Positively contributing to the Impact Large Core—ESG portfolio's performance during the quarter was an overweight to Tesla Inc. (TSLA) within the Consumer Discretionary sector. The stock gained 106.1%, partly on expectations it will be added to the S&P 500 Index.

The portfolio benefited from not having an allocation to Berkshire Hathaway Inc. (BRK.B), which declined 1.7% in the quarter. The stock lagged the market's rise, suffering, in part, due to a large cash balance and lackluster performance of its investment portfolio.

An overweight to Moody's Corporation (MCO) also contributed to performance, as the stock rose 30.2%, outperforming the broader Financials sector.

Portfolio performance suffered during the quarter due to having no allocation to Facebook Inc. (FB), which returned 36.1%. Investors believe the company stands to benefit from an increase in user engagement and e-commerce demand.

An overweight to Medtronic PLC (MDT) detracted from performance results despite gaining 2.4% in the quarter. Investors weighed the company's outlook during the pandemic, as hospitals throughout the country pause elective procedures.

Visa Inc. (V), which held an overweight in the portfolio, returned 20.1% during the quarter. Despite the stock's strong gain, it lagged relative to the Information Technology sector, which returned 31.3%.

Markets advanced in the second quarter, as investors turned hopeful that medical treatments for novel coronavirus are not far in the distant future. Although the global pandemic's initial shock has subsided, investors will keep a close eye on both economic and medical developments in the second half of 2020. The portfolio remains sector neutral and well diversified within sectors. We believe its risk-aligned portfolio construction positions it to effectively track the large cap core segment, irrespective of overall market performance.

Model Portfolio Attribution

	Performance Driver	Active Return Contribution	Portfolio Exposure	Average Weight in Model	Comments
Contributors	Tesla Inc.	+39 bps	Overweight	1.31%	The stock gained 106.1%, partly on expectations it will be added to the S&P 500 Index.
	Berkshire Hathaway Inc. Class B	+21 bps	No exposure	0.00%	The stock declined 1.7%, suffering, in part, due to a large cash balance and lackluster performance of its investment portfolio.
	Moody's Corporation	+19 bps	Overweight	1.39%	The stock rose 30.2%, outperforming the broader Financials sector.
	S&P Global Inc.	+17 bps	Overweight	1.22%	The stock rose 34.7%, as the company reported strong first-quarter financial results.
	Abiomed Inc.	+17 bps	Overweight	0.30%	The stock gained 66.4% in the quarter, as the FDA approved the company's heart device for COVID-19 patients.
Detractors	Facebook Inc.	-26 bps	No exposure	0.00%	The stock returned 36.1%, as investors believe the company stands to benefit from an increase in user engagement and e-commerce demand.
	Medtronic PLC	-22 bps	Overweight	2.13%	Although the stock returned 2.4%, investors weighed the company's outlook during the pandemic.
	Visa Inc.	-20 bps	Overweight	3.16%	The stock gained 20.1%, but lagged the overall Information Technology sector.
	Amazon.com Inc.	-20 bps	No exposure	0.00%	The stock gained 41.5% on strong demand for its services in the wake of COVID-19.
	Starbucks Corp.	-16 bps	Overweight	1.02%	The stock increased 12.5%, but underperformed relative to the Consumer Discretionary sector.

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Quantitative Research Group

Disclosure

The **Russell 1000 Index** is a market capitalization weighted benchmark index made up of the 1000 largest U.S. companies in the Russell 3000 Index. The **Russell 1000 Value Index** refers to a composite of large and mid-cap companies located in the United States that also exhibit a value probability. The **Russell 3000 Index** is an unmanaged index considered representative of the US stock market.

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